NOTES

WASHINGTON NOTES

LOANS AND SECURITIES PRICES

The results of the government's second great loan operation for the year 1917 are now definitely known. Final statistics show that total subscriptions have amounted to more than four billion six hundred million dollars, an oversubscription of 54 per cent of the three billion dollars originally offered. This is a greater oversubscription than was received in the case of the first Liberty Loan when two billions were offered and about three billions of subscriptions were received. On this occasion a total of nine million four hundred thousand individual subscriptions were presented to the Treasury, and of these subscribers about 99 per cent subscribed in amounts ranging from fifty dollars to fifty thousand dollars.

While the success of the loan as measured by the volume of subscriptions and the number of subscribers has thus been phenomenal, the careful observer is equally interested in the conditions underlying the loan and the effect it is likely to exercise upon the banking and business community. A review of conditions as existing at the close of the operation shows that the assistance of the banks has been enlisted to a considerably greater extent than in the former transaction. Discounts of paper secured by government obligations, by Federal Reserve Banks, amounted on November 30 to $499,000,000 or about $400,000,000 more than the maximum of such discounts under the first Liberty Loan. No figures are as yet available to show in any reliable way what proportion of the bonds have been actually taken by the banks themselves as a matter of permanent ownership, and what proportion are being carried with a view to eventual liquidation by subscribers who are paying for them on the "instalment plan." The only thing that seems certain is that the aid of the banks has been more largely enlisted on this occasion than on the first, and that a somewhat longer period will be required to transfer the bonds completely to private ownership.

Various reasons for this condition of affairs may be cited. One is the fact that in subjecting the bonds to taxation to the extent determined upon in connection with this issue, the authorities of the govern-

ment necessarily rendered them somewhat less attractive to persons of very large income desirous of escaping the super-tax. Again, the wide distribution given to the bonds and the presence of small subscribers in very large numbers imply the necessity for a very substantial amount of aid in the form of loans extended by the banks to persons who desire to pay for the bonds out of current income. Until a reasonable amount of time has been allowed for the paying off of these loans, the banks cannot expect to free themselves completely of this responsibility. The very great oversubscription and the wide distribution show conclusively that the saving and purchasing power of the community is much greater than had been expected, and that the nation at large possesses a power of absorbing securities which promises well for the success of the future government financing, heavy as it must be.

On the other hand, developments accompanying the loan suggest strongly the price that must be paid for this success. Severe declines in the market for securities have shown that even with great activity and prosperity on the part of basic industries they cannot maintain the selling values of their shares and bonds in the face of a general withdrawal of purchasing power. The government's lending operations, in fact, have resulted in a withdrawal of such purchasing power to an extent that almost unavoidably disturbs the investment market necessary for the maintenance of normal prices for ordinary securities. This condition of affairs is not one that need cause alarm in its purely speculative aspect, but is of more serious moment from two standpoints—that of the savings banks and other institutions that have purchased these securities at what was supposed to be normal prices, but which now find the value of their investments very greatly lowered; and that of the concerns themselves, which, if compelled to re-finance or to seek new capital for current employment, will find themselves obliged either to pay abnormally high rates of interest or to submit to a discount on their securities, which would be equivalent to the same thing. This is perhaps the most serious aspect of the financial situation brought about by government borrowing, and is of course unavoidable if it be granted that the supply of capital available in the market at any given time is limited, so that some purposes must be sacrificed in order to attain the success of others whose character is more necessary to the community.

CONTROL OF FOREIGN EXCHANGE

In accordance with the powers granted in the so-called trading with the enemy act (which became law on October 6) the President,

on November 28, issued executive instructions transferring to the Federal Reserve Board, under supervision of the Treasury Department, the oversight and control of foreign exchange transactions. This, combined with the oversight of gold movements already intrusted to the Federal Reserve Board on behalf of the Treasury, gives to that organization a very broad power of controlling the foreign payments of the United States. Such power is of course closely entwined with, and dependent upon, the control of the movement of merchandise exercised under present conditions by the War Trade Board, but, taken in conjunction with the powers of the latter, it affords an almost absolute authority over foreign commerce. Relations with the belligerent countries of Europe are already practically upon a government-controlled basis by reason of the fact that the United States government is furnishing the means with which to finance the movement of the supplies and munitions required in the conduct of the war. Exchange relations with European neutrals are practically under war restriction and control because of the business connections existing between those nations and Germany. This confines the regulation of foreign exchange in any active sense largely to South America and the Orient.

As matters have developed since the coming on of the war, the United States, although having a large favorable balance of trade as against the rest of the world, finds itself subject to an unfavorable trade balance with respect to foreign neutral nations. This unfavorable balance would, in ordinary times, be cleared or offset against the favorable balances derived from trade with other countries, only a net balance remaining to be adjusted. The artificial restrictions upon, and interferences with, trade growing out of the present war have, however, greatly changed this condition of affairs, so that balances with each country have to be dealt with practically upon an independent basis. The main purpose of such control of foreign exchange is to provide a means of making payment at a reasonable rate for goods imported to the United States. This purpose, if it is to avoid the shipment of gold in payment for such goods, implies the adjustment of imports and exports so as to avoid the growth of a large balance unfavorable to the United States, the only possible alternative thereto being an arrangement whereby foreign countries would accept payments either in their own securities held by American citizens or in obligations of the United States or its domestic enterprises.

Probably less has hitherto been known about the details of the foreign exchange operations of American banks and banking houses

than about those of any other country, and this has been particularly true since the opening of the present war. The system of inspection and licensing now to be put into effect will, however, provide new data of a kind not heretofore available and will render the problem considerably simpler than it now appears on the surface. The so-called depreciation of the American dollar in foreign markets, notwithstanding that in some of these very markets there is a debtor balance to the United States, is likely to continue to exist as long as the present artificial parity of relationship between the American dollar and the British pound sterling is maintained, as it now has been for some two years past. This situation makes the possible direct results to be expected from the proposed control of foreign exchange probably less striking and conclusive than they would otherwise be. The success to be had will itself depend very largely upon the actual requirements for necessary raw materials that must be filled, and the success experienced in inducing countries from which they are imported to take an equivalent amount of goods in payment.

GROWTH OF FEDERAL RESERVE SYSTEM

The movement of state-chartered institutions into the Federal Reserve System, which had already assumed considerable proportions during the month of October, has continued during November and now seems likely to be maintained until practically all of the larger state banks and trust companies of the country have entered the system. At the close of November the total capital and surplus of the 176 state member banks is announced as $427,000,000 and their total assets as $4,275,000,000. An analysis of the new membership throws some interesting light upon the attitude of the state banks toward the system.

The trust companies and larger institutions of the states, many of which have lately enrolled, are, in not a few cases, institutions whose membership is quite obviously not likely to be of direct profit to them because of the fact that their business does not involve a large investment in paper of the kinds now eligible for discount. On the other hand, a number of the incoming members are small institutions scattered over the country, which have apparently made application either because of a desire to strengthen the system in a time of national necessity or have found it to their interest as a matter of local prestige to obtain membership. While these institutions may and probably will from time to time be able to take advantage of the rediscount privileges of the system, it may be doubted how far they can steadily and consistently make use of it unless they modify their present type of business.

The question is thus raised whether the great body of state banks is likely to be brought into membership as a result of the movement recently begun in that direction, and whether there may not be an increasing pressure of demand for the modification of the system in such a way as to permit of the discount of paper of the classes held by many of the state banks and trust companies.

In various quarters during the last session of Congress the latter suggestion was put forward and it was then urged by members of both Houses that the Federal Reserve Act be modified to permit the rediscount of paper based upon securities of various kinds. Bills to that effect were introduced; and this proposal, while mainly in the interest of the financial community at large, has an important and direct bearing upon the question of membership, since it has always been noted by the trust companies and by state bankers generally that the rigid requirements of the system with respect to the discounting of liquid paper considerably limited the extent to which state institutions could expect to take advantage of it. This seems to suggest that the future development of the Federal Reserve System may still be a matter for very serious consideration, the real point involved being the maintenance of its character as a strictly liquid commercial banking organization requiring its members to conform their business to its rules as against that of an institution designed partly to render relief or aid in operations which though desirable and necessary industrially might or might not be of a liquid commercial character. There seems to be no reason to think that this question must be disposed of in the immediate future, but it will quite clearly call for answer in one way or another before the Federal Reserve System attains its ultimate development.